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RECENT DEVELOPMENTS RELATED TO TRANSNATIONAL CORPORATIONS AND INTERNATIONAL ECONOMIC RELATIONS

The triad in foreign direct investment

Report of the Secretary-General

SUMMARY

Worldwide flows of foreign direct investment continued to grow rapidly towards the end of the 1980s, reaching a level of nearly $200 billion in 1989, for a total world stock of $1.5 trillion. Of total flows, $163 billion were invested in developed countries and $30 billion in developing countries. Ten developing countries accounted for three fourths of total inflows to developing countries.

The present report addresses itself to the global structure of foreign direct investment, focusing on the role of the triad (the United States of America, the European Community (EC) and Japan), and the policy implications that stem from it. The major findings are are follows:

(a) The bipolar pattern of foreign direct investment of the early 1980s had been transformed by the end of the 1980s into one dominated by the triad, which accounted consistently for some 80 per cent of worldwide outward stocks and flows;

* E/C.10/1991/1.

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(b) Integration of foreign direct investment within EC has reached such a level that EC can now be properly considered a single home region. If current trends continue, EC could eventually surpass the United States as the most important host region. Japan, which invests more abroad than does the United States in terms of flows, could soon surpass the United States as a home country in terms of stock;

(c) The low level of foreign direct investment in Japan stands out as a serious imbalance against an otherwise growing convergence of the triad members in outward and inward foreign direct investment;

(d) The rate of growth of foreign direct investment within the triad has outpaced that in the rest of the world. The increasing share of intra-triad stock reflects, in part, the growing strategic orientation of transnational corporations from the triad towards other triad members. Japanese transnational corporations in particular appear to be pursuing a strategy to build self-contained, regionally sustainable networks of affiliates in each of the triad members;

(e) The triad members individually also dominate foreign direct investment in most other countries. The pattern for over 30 host countries shows a clustering of these countries around a single triad member, typically located in the same region;

(f) Transnational corporations from the triad appear to be building integrated core networks of affiliates clustered around their home country.

The growing role of foreign direct investment, especially in its interrelationship with trade, technology and financial flows, makes it a new engine of growth and raises anew the question of governance, particularly in a multilateral context. At the same time, special policy measures need to be taken so that developing countries are not marginalized in the process. In doing so, it should be recognized that policies aimed at attracting transnational corporations through traditional liberalization and incentive instruments become less effective as virtually all countries move in this direction. Such policies need to be supplemented by improvements in economic locational advantages, including the enlargement and growth of regional markets.

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INTRODUCTION

"The Old World was ruled by the logic of the triad: three times, three ages, three persons, three continents."

Octavio Paz

1. Is the new world of international economic relations also ruled by the logic of a triad? Certainly, the concept of a triad has been prominent in recent discussions of the evolution of international trade relations and corporate strategies. 1/ Does this logic apply in the world of foreign direct investment as well? As yet, there have been no empirical investigations of this question. This issue, which carries important policy implications, is the focus of the present report.

2. Among the external factors which exert influence on international economic relations, foreign direct investment has become increasingly important. This is illustrated by the much faster growth of foreign direct investment than of both world trade and output, the intensifying efforts of virtually all countries to attract foreign direct investment (including investment in industries previously barred to foreign investors) and by the increasingly global strategies of transnational corporations. Furthermore, foreign direct investment is not only a factor of economic development in its own right, but it is also closely linked with trade, technology transfer and financial flows. The global pattern of foreign direct investment stocks and flows, along with the global patterns of trade, technology transfer and financial flows constitute, to a large degree, the structural attributes of the world economy.

3. Changing patterns of world trade, especially during the 1950s and 1960s, led to an increasing share of developed countries and a declining share of developing countries in total trade. Since trade is an engine of economic growth and international competitiveness, the declining share of developing countries became a source of concern. This concern was addressed in multilateral forums. Worldwide efforts ensued to reverse these patterns, and changes were introduced in the multilateral trading system, notably through the establishment of preference systems for developing-country exports.

4. Some recent discussions and analysis of global trade patterns have investigated whether these patterns are characterized by trade blocs or integration groupings which facilitate market access for some countries while making access more difficult for others. For instance, the Trade and Development Report, 1989 prepared by the United Nations Conference on Trade and Development (UNCTAD), examined "tripolar trading blocs", while the 1990 report on international trade, prepared by the secretariat of the General Agreement on Tariffs and Trade (GATT), dealt with, among other things, trade blocs and "trade centres". 2/ This type of analysis has not yet been attempted for global foreign-direct-investment flows, although efforts in this direction have begun - for instance, in a recent analysis by UNCTAD of an investment-led trading bloc centred around Japan. 3/ Yet, a similar understanding of the global patterns of foreign direct investment is as

important as a knowledge of trade patterns and has no less important policy implications. Such an understanding is crucial for meaningful multilateral actions in the area of foreign investment. In particular, the continuing fall in the share of developing countries in global flows points to the need for multilateral responses in the area of foreign direct investment.

5. Accordingly, the present report, which has been prepared in response to a request made by the Commission on Transnational Corporations at its sixteenth session, is a first attempt to examine the global structure of foreign direct investment and the policy implications that emanate from it. It focuses on the role of the triad (the United States of America, the European Community and Japan) in the global pattern of foreign direct investment during the 1980s. Section I describes briefly global trends in the area of foreign direct investment, where flows reached $196 billion in 1989 and world stock grew to nearly $1.5 trillion. Since some four fifths of outward stocks and flows are accounted for by the triad members, section II examines how the relative importance of the individual triad members changed during the 1980s (sect. II.A), how their interrelationships have developed (sect. II.B) and to what extent developing countries are linked in their foreign-direct-investment relationships to one of the triad members (sect. II.C). An effort is made to explain the resulting patterns, including through an analysis of corporate strategies. Section III starts by placing the analysis of foreign direct investment in the wider context of the world economic system, emphasizing the central role of foreign direct investment as an engine of growth in its interrelationships with trade, technology and financial flows (sect. III.A). It then raises the issue of governance, particularly in its multilateral dimension (sect. III.B), and pays special attention to implications for developing countries, including policy options to improve the flow of foreign direct investment to those countries (sect. III.C).

I. RECENT TRENDS

A. Global trends: increased importance of developed countries

6. After having nearly tripled between 1984 and 1987, worldwide outflows of foreign direct investment increased by 20 per cent in 1988 and 1989, to reach an absolute level of $196 billion (table 1). By 1989, the total worldwide stock of foreign direct investment had reached approximately $1.5 trillion. The five major home countries (France, Germany, Japan, United Kingdom of Great Britain and Northern Ireland, United States of America) maintained their 70 per cent share of total outflows throughout the 1980s. The United Kingdom, the United States and Japan were the largest home countries for outflows during the period 1980-1989, with the United Kingdom as the largest home country for the period overall, with average annual outflows of $17 billion (20 per cent of world outflows). However, outflows from Japan have exceeded those from the United States since 1986, and surpassed those from the United Kingdom in 1989, such that Japan replaced the United Kingdom as the largest source country of investment flows, accounting for 23 per cent of total worldwide outflows that year.

Table 1. Outflows of foreign direct investment from five major home countries, 1985-1989

Home country	1985	1986	1987	1988	1989	1980-1984	1985-1989
	Absolute value (billions of dollars)					Percentage shares	
France	2.2	5.4	9.2	14.5	19.4	6.0	8.0
Germany	5.0	10.1	9.2	11.2	13.5	7.4	7.8
Japan a/	6.4	14.5	19.5	34.2	44.2	8.9	18.8
United Kingdom	11.1	16.5	31.1	37.0	32.0	19.4	20.2
United States b/	8.9	13.8	28.0	13.3	26.5	28.1	14.3
Total	33.7	60.2	97.1	110.2	135.6	69.8	69.1
Developed countries	52.1	84.7	132.6	155.4	187.1	98.4	96.8
Developing countries	1.2	1.7	2.4	5.9	8.9	1.6	3.2
All countries	53.3	86.5	135.0	161.3	196.1	100.0	100.0

Source: International Monetary Fund, balance-of-payments tape, retrieved on 10 January 1991.

a/ Data for Japan do not include reinvested earnings.

b/ Excluding outflows to the finance (except banking), insurance, and real estate sectors of the Netherlands Antilles; also excluding currency translation adjustments.

7. Foreign-direct-investment inflows to developed countries have grown at an average annual rate of 25 per cent since 1983, to reach a value of $163 billion in 1989. The five major home countries, with the exception of Japan, are also the largest host countries, with an average share of 57 per cent of world flows during the 1980s.

B. Developing countries

8. Foreign-direct-investment inflows to the developing countries have grown consistently since 1984, posting an average annual growth rate of 16 per cent to reach $30 billion in 1989 (see table 2). In spite of a near doubling of average annual flows to the developing countries between 1980-1984 and 1985-1989, their share in worldwide inflows between these two periods fell from 25 per cent to 19 per cent. Ten developing economies maintained a share of about three fourths of total inflows to developing countries throughout the 1980s. The 10 and their respective shares of the $16 billion in average annual inflows to developing

Table 2. Inflows of foreign direct investment to developing regions, 1980-1984, 1985-1989 and 1988-1989

Host region	1980-1984	1985-1989	1988-1989	1980-1984	1985-1989	1988-1989
	Absolute value (billions of dollars)			Percentage share		
All countries	49.70	119.00	173.00	100.0	100.0	100.0
Developing countries	12.50	22.20	29.20	25.2	18.6	16.9
Africa	1.20	2.60	3.20	2.4	2.2	1.9
Latin America and Caribbean	6.10	8.30	10.00	12.3	7.6	5.8
East, South and South-East Asia	4.70	10.70	15.20	9.4	9.0	8.8
Oceania	0.13	0.14	0.20	0.3	0.1	0.1
West Asia	0.37	0.40	0.54	0.8	0.3	0.3
Other a/	0.04	0.03	0.05	0.07	0.03	0.03
Ten largest host countries	9.00	14.30	19.20	18.1	12.0	11.1
Least developed countries	0.19	0.15	0.17	0.4	0.1	0.1

Source: Estimates made by the United Nations Centre on Transnational Corporations, based on International Monetary Fund balance-of-payments tape, retrieved on 10 January 1991, estimates made by the Organisation for Economic Cooperation and Development and national sources.

a/ Including Malta and Yugoslavia.

countries during the period 1980-1989 (excluding tax havens) are Singapore (12 per cent), Brazil (12 per cent), Mexico (11 per cent), China (10 per cent), Hong Kong (7 per cent), Malaysia (6 per cent), Egypt (6 per cent), Argentina (4 per cent), Thailand (3 per cent) and Colombia (3 per cent). 4/

9. While the shares of Africa and East, South and South-East Asia in total worldwide inflows remained stable during the periods 1980-1984 and 1985-1989, the share of Latin America in total world inflows declined from 12 per cent to 7 per cent, although in absolute terms inflows to Latin American increased. As a share of inflows to only developing countries, Latin America also experienced a substantial decline, from 49 per cent to 38 per cent, while the corresponding share of South-East Asia increased from 37 per cent to 48 per cent. Continued debt-related problems in Latin America are in some measure behind the decade-long decline in the region's share of both worldwide inflows and flows to developing countries. The share of Africa in total average annual inflows to developing countries increased from 9 per cent in 1980-1984 to 12 per cent in 1985-1989, with oil-exporting countries in Africa accounting for the majority of the increase.

10. The least developed countries accounted for 0.7 per cent of average annual inflows to developing countries in 1985-1989, down from 1.5 per cent in 1980-1984. Since flows to developing countries are highly concentrated in newly industrialized and resource-rich countries, the position of the least developed countries is not likely to improve in the foreseeable future.

11. Overall, net resource transfers through foreign direct investment to developing countries have shown a reversal from -$1.5 billion in 1980-1984 to $3.5 billion in 1985-1988. 5/ This shift is due to a decrease in repatriated dividend and profit payments coupled with increased foreign-direct-investment inflows. The positive transfer on account of foreign direct investment contrasts with negative transfers exceeding $30 billion in both these periods on account of private credit.

12. By the end of 1990, virtually all countries in Central and Eastern Europe had passed legislation encouraging foreign direct investment. The number of joint ventures in Czechoslovakia, Hungary, Poland, the USSR and Yugoslavia grew rapidly in 1990, registering more than 9,000 by the end of the year, compared with about 3,035 at the beginning of the year. 6/ Nevertheless, very few of these ventures have actually commenced operations; less than 10 per cent, for example, have done so in the USSR. 7/ The current home countries, most of which are in Western Europe, are likely to remain the largest investors over the next five years, although several Japanese companies surveyed have indicated that they plan to invest considerable amounts in Central and Eastern Europe. 8/ However, the growth in the number of new joint ventures is likely to decline compared with 1990, given the current climate of deteriorating conditions and inadequate infrastructure, coupled with recessionary forces in the United States and Western Europe.

II. PATTERNS OF FOREIGN DIRECT INVESTMENT IN THE TRIAD

A. Triad members: the United States, the European Community and Japan

13. In the early 1980s, the global pattern of foreign direct investment could be characterized as bipolar, dominated by the United States and the European Community (EC), with the latter not yet fully integrated in terms of foreign-direct-investment flows. By the beginning of the 1990s, Japan had emerged as an equally important foreign-direct-investment power, at least as far as outward flows were concerned. As a result, the global pattern of foreign direct investment can now be characterized as tripolar, with EC, the United States and Japan being the members of the triad. The triad accounts for some four fifths of total outward stocks and flows, a percentage substantially higher than in the area of trade, where the triad accounted for one half of total world trade during the 1980s. Furthermore, while other countries have somewhat improved their relative position as outward foreign investors (although the triad still accounts for over 80 per cent of outward world stock), a growing share of worldwide investment is being concentrated in the triad itself (table 3).

Table 3. Foreign direct investment to/from the European Community, the United States and Japan, 1980-1989

	Stock				Flow (annual average)			
	Outward		Inward		Outward		Inward	
	1980	1987	1980	1987	1980 1984	1985 1989	1980 1984	1985 1989
EC (excluding intra-EC foreign direct investment)								
Billions of dollars	153	343	143	244	18	39	10	19
Percentage of world total	33	37	31	26	41	37	23	19
United States								
Billions of dollars	220	322	83	272	14	18	19	46
Percentage of world total	46	35	18	28	31	17	41	46
Japan								
Billions of dollars	20	99	3	9	4	24	0	0
Percentage of world total	4	11	1	1	10	23	1	0
Triad								
Billions of dollars	398	765	230	525	36	81	29	65
Percentage of world total	84	83	50	55	82	77	64	65
World								
Billions of dollars	474	925	464	957	44	105	45	100
Memorandum item:								
EC (including intra-EC foreign direct investment)								
Billions of dollars	203	463	188	364	22	59	15	40
Percentage of world total	39	44	37	34	47	47	30	33

Source: Handbook on Foreign Direct Investment (to be issued as a United Nations publication).

Note: The data on outward stock for Japan for 1987 include reinvested profits. The data on intra-EC are estimates made by the United Nations Centre on Transnational Corporations, based on national sources. The data for EC do not include Greece, Ireland and Luxembourg.

14. As a result of the shift from a bipolar to a tripolar pattern of foreign direct investment, the share of the United States in the triad's total outward stocks and flows decreased substantially in favour of the rising share of Japan; in terms of average outflows, Japan surpassed the United States during the second half of the 1980s by a substantial margin. These developments are examined in the following sections, which analyse the position of each triad member, current trends regarding intra-triad foreign direct investment and the foreign-direct-investment linkages between the triad and developing countries.

1. The United States and Japan

15. The United States is no longer the world's most important foreign investor, as it was in 1980. By 1987, EC had become the world's largest source of foreign direct investment in terms of both stock and flows, and Japan now invests more abroad than does the United States in terms of flows. At the same time as the role of the United States as a home country was declining, its role as a host country was growing; in fact, the overall rise in world foreign direct investment located in the triad is largely due to increased foreign direct investment located in the United States.

16. Over the same eight-year period, outflows of foreign direct investment from Japan increased nearly sixfold. In 1980, Japanese outflows were less than one third of the outflows from the United States; by 1988, they were one third higher. However, as a relative newcomer to the triad (at least in terms of foreign direct investment), Japan does not yet match the United States or EC in terms of outward stock, although it is likely that it will do so within the next decade. In contrast, foreign-direct-investment stock and flows into Japan have remained very low over the decade and explain the relatively low share (about one half) of worldwide inward stock located in the triad as a whole. In terms of its position as a host country, then, Japan is not an equal triad member, nor is it likely to become one until transnational corporations take further advantage of existing investment opportunities and the remaining barriers to such investment are lowered.

2. The European Community

17. During the decade of the 1980s, EC so increased its importance in the triad as a foreign investor that its share of total outward stock (37 per cent) is now slightly above that of the United States. Its relative position as a host region, in contrast, declined somewhat during the period, although in absolute terms foreign direct investment into EC grew at about 8 per cent a year. Much of the relative decline in EC as a host region and its concurrent rise as a home region can be explained by shifts in the bilateral foreign-direct-investment relationship between EC and the United States, in which investment from the former to the latter grew far more rapidly than flows in the reverse direction. These relationships are analysed in more detail below.

18. The 1992 programme to unify the regional market has provoked an unprecedented level of intraregional foreign direct investment within EC, such that intra-EC foreign direct investment increased from one quarter of total inward stock in EC in 1980 to one third in 1987, when it reached a level of approximately $120 billion. This rapid increase (about 15 per cent a year) outpaced the growth of intra-EC trade, which grew at only 9 per cent a year over the 1980s. Growing foreign direct investment between States members of EC means that it is increasingly possible to conceive of the region as a single, integrated home and host region for foreign direct investment to the rest of the world. The European Community is now the dominant investor in six EC countries, accounting for over 50 per cent of inward stock, whereas in 1980 it was dominant in only one EC country. 9/ The accelerated integration of the regional economy is further illustrated by the fact that intra-EC investment flows grew by an average of 38 per cent a year from 1980 to 1987, while flows from EC to the rest of the world grew at only 17 per cent a year.

19. In terms of corporate strategy, the increasing importance of intraregional foreign direct investment within EC can be characterized as the "regionalization" of EC industry (as explained below), motivated in large part by the 1992 programme of the unification of the regional market. The level of intra-EC foreign direct investment in EC is intensifying, since foreign direct investment flows within the region have grown substantially faster than inflows from the United States. Even though the latter have risen by about 24 per cent a year, the United States share of total inward foreign-direct-investment stock in EC declined from 42 per cent in 1980 to 36 per cent in 1987. This is a reflection of the already strong positions held by United States transnational corporations, many of which had already built up substantial pan-European capabilities by the 1970s.

20. Many EC transnational corporations, in contrast, are only now rationalizing their operations on a regional scale, in part encouraged by policies to foster pan-European firms (with moves by the Commission of the European Communities to develop EC-wide competition and company laws, for instance). The outcome of EC-wide industrial restructuring may be a shift from an economy characterized by a set of "national champions" which were protected on a national level, to one with a far smaller number of larger, regional "EC champions" which would look to EC rather than the home country as their principle market and their relevent policy and investment arena.

21. The restructuring of many EC industries reflects the strategies of EC transnational corporations to regionalize their activities, so that the EC region, rather than the firm's country of origin, will increasingly be considered the relevent home base. In those industries which were fragmented because of non-tariff barriers, such as telephone exchange manufacturing, semiconductors, computer services and white goods, intra-EC merger and acquisition activity has led to a sharp decline in the number of competitors and the creation of a handful of EC-based players. The need to achieve scale in the face of increasingly international competition has led to a number of large-scale cross-border acquisitions, particularly in the paper and motor vehicles industries. Consolidating distribution systems on a regional scale has been another important strategic objective of EC companies, such that the wholesale-distribution sector

accounted for the highest number (76) of EC cross-border acquisitions in the first half of 1990. 10/

22. The above analysis suggests that the role of the triad in the world economy as measured by foreign-direct-investment stock and flows is significant and that its role as a recipient of total foreign direct investment has increased over the 1980s. Moreover, the triad's position in worldwide foreign direct investment is greater than its share of world trade flows; in the future, this discrepancy is likely to increase, given the high growth rates of foreign direct investment from and to the triad versus the growth of the triad's trade with the world. Within the triad, several shifts can be observed over the 1980s: the decline of the United States as the major home country and its emergence as the most important host country; the integration of EC through intraregional foreign direct investment and the rise of that region as the most important home country in the triad; and extremely high rates of growth of outflows from Japan, which are likely to give that country an equal, if not greater, role in the triad vis-à-vis the other two members in the near future.

B. Intra-triad investment relationships

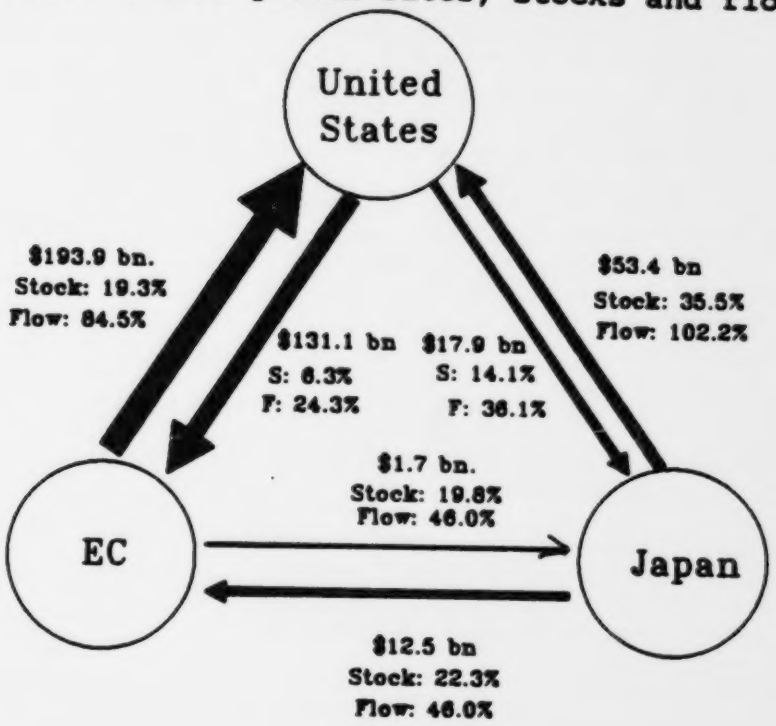
1. Significance of intra-triad foreign direct investment in global stocks and flows

23. Figure I shows that between 1980 and 1988 intra-triad foreign-direct-investment stock nearly tripled, from $142 billion to $410 billion. In 1980, the foreign-direct-investment stock within the triad accounted for 30 per cent of the worldwide stock of inward investment; by 1988, intra-triad stock had increased to an estimated 39 per cent of worldwide inward stock. Intra-triad trade also grew more rapidly than world trade, increasing from 13 per cent to 17 per cent of world trade over the period. Thus, in terms of both foreign direct investment and trade, interactions within the triad have outpaced interactions in the rest of the world and between the triad and the rest of the world, indicating a faster rate of integration among the triad than between the triad and the rest of the world.

24. The large and growing share of intra-triad activities in worldwide stock and flows of foreign direct investment as well as in worldwide trade flows can in large part be explained by the market size of the triad, a changing regulatory framework (particularly in EC) and emerging corporate strategies in the 1980s. Although growth of real gross domestic product (GDP) in the triad was only 3 per cent during the period 1980-1987, the triad's combined GDP accounted for $11 trillion, or 65 per cent of world GDP in 1987, with the United States, EC and Japan accounting for 26 per cent, 25 per cent and 14 per cent of worldwide GDP, respectively, 11/ The triad members are also among the world's most important trading areas, accounting for 50 per cent of world trade in 1989, with the United States, EC and Japan accounting for 21 per cent, 20 per cent and 9 per cent of total world trade, respectively (excluding intra-EC trade).

Figure I. Intra-triad foreign direct investment, 1988

(Dollar figures show 1988 stock; percentages show average annual growth rates, stocks and flows) a/



Source: Handbook on Foreign Direct Investment (to be issued as a United Nations publication).

a/ Stock growth rates are for 1980 to 1988. Flow growth rates are for 1985 to 1989.

25. A changing regulatory framework also helps explain the rapid growth of intra-triad investment stocks and flows in the 1980s. In Europe, the 1992 single market programme has attracted foreign direct investment from many countries through the pull of projected market growth as well as the possibility (real or imagined) of future difficulties in exporting to the region from outside EC. In the United States, some of the growth of inward EC and Japanese investment can be explained by the relative openness of United States regulations governing inward foreign direct investment, coupled with a fall in the value of the dollar. Pressure to reduce Japan's trade surplus with the United States is also likely to have played a role. Finally, the growth of EC and United States investment into Japan could be attributed to a gradual relaxation of policies in Japan, in response to demands by its two key trade and investment partners.

26. Finally, the growth of intra-triad foreign direct investment can in part be explained by heightened competition between increasingly global transnational corporations in research- and technologically-intensive industries. In the 1980s, the economy of each triad member became increasingly linked to such industries as computers and electronics, specialty chemicals and communication equipment, whose growth is sustained through high and continuous expenditures in research and development. The growing significance of research- and technology-intensive industries in the economy of each triad member is an important factor in increased intra-triad foreign-direct-investment flows, as transnational corporations seek to gain access to new technologies, to join in alliances with firms with complementary technologies and to amortize their fixed research expenditures by expanding their market share.

2. Relative significance of intra-triad investment relationship segments

27. Figure I shows that, in terms of stock, the most important foreign-direct-investment relationship within the triad is between EC and the United States, which together accounted for 79 per cent of intra-triad foreign-direct-investment stock in 1988. However, Japan's share of intra-triad stock more than tripled in the 1980s, from 5 per cent in 1980 to 16 per cent in 1988. The United States was the most important host country for foreign direct investment from both Japan and EC. The following sections analyse the relative significance of bilateral intra-triad foreign-direct-investment relationships (expressed by stock data) and emerging trends which are reshaping those relationships (as expressed by size and growth of flows).

(a) Intra-triad foreign direct investment by the European Community

28. The European Community accounts for the largest share (48 per cent) of intra-triad foreign-direct-investment stock. Most of that investment is captured by EC investment in the United States; Japan, as a host country, accounts for less than 1 per cent of the EC intra-triad investment stock ($196 billion in 1988). The rapid rise of intra-EC foreign direct investment over the 1980s has not prevented an even more rapid rise in EC investment located in the United States: the latter, with $194 billion of inward stock from EC, is still a more important recipient of

EC foreign direct investment than EC itself. Indeed, the size and growth of EC investment in the United States has been such that EC is now the largest home country in the triad. From a strategy point of view, many of these investments are aimed at gaining the critical mass which will propel EC companies to the status of global competitors, able to compete effectively with large American and Japanese transnational corporations. For instance, the French company Michelin's 1989 purchase of Uniroyal-Goodrich made it the world's largest tyre manufacturer; other major EC transnational corporations with substantial investments in the United States include ICI of the United Kingdom, Philips of the Netherlands, Rhône-Poulenc and Thomson of France and BASF of Germany. The United States market accounts for upwards of 30 per cent of sales for many of those companies, which also export hundreds of millions of dollars from their American subsidiaries to overseas markets. 12/

(b) Intra-triad foreign direct investment by the United States

29. In 1988, the United States had $149 billion (stock) invested in the triad, of which 88 per cent was located in EC. In terms of flows, foreign direct investment into Japan has grown rapidly (though from a small base), while growth of flows to EC, at 24 per cent a year, was the slowest growth rate of all flows within the triad. This is due in part to the strong foreign investment position in EC already attained by United States transnational corporations by the late 1980s. United States transnational corporations, many of which were world market leaders in the 1960s, have had substantial investments in EC since that time. They often tended to treat EC as a regional market from the outset and to devise single European strategies where appropriate. United States transnational corporations, therefore, do not face the intense pressure to make new investments in EC as do most Japanese transnational corporations, or to regionalize existing operations to prepare for the single market as do most European transnational corporations: many of them are already the leaders in key EC markets. Evidence of the pre-existing regional integration of United States transnational corporations networks in Europe is given by the fact that, by 1982 (three years before the 1992 programme was initiated), 51 per cent of the non-United States exports of EC-based United States affiliates went to other affiliates of the same parent, versus only 39 per cent for all United States affiliates worldwide, indicating a relatively high degree of cross-border vertical integration for the EC-based affiliates. Furthermore, 72 per cent of the non-United States exports of the latter were sold to other EC countries, indicating that most of the international integration of EC affiliates took place within EC itself. 13/

30. Notwithstanding this advantage of early rationalization, EC has grown as a key region for the globalization strategies of United States transnational corporations, as witnessed by the recent decision of IBM to move its communications headquarters from the United States to London. While organizational changes such as this are not captured in foreign-direct-investment data, they reflect a qualitative increase in the importance of EC as a location for foreign direct investment by United States transnational corporations.

(c) Intra-triad foreign direct investment by Japan

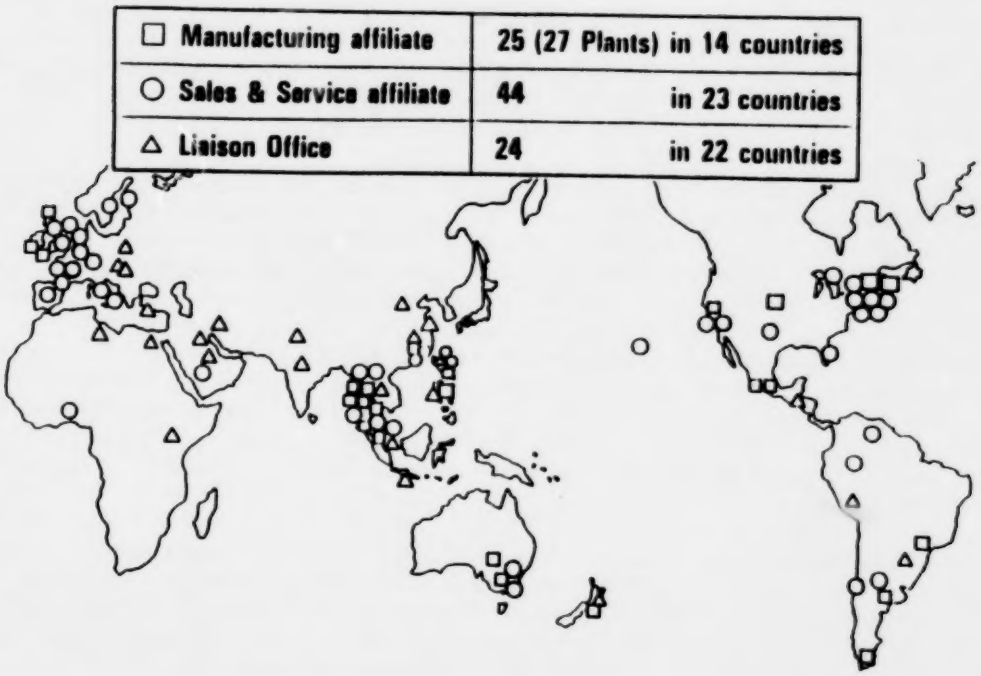
31. While the absolute volume of Japanese foreign-direct-investment stock in the triad is still relatively low ($66 billion), growth of outflows in the late 1980s has been remarkable. According to approvals recorded in Japan, in the two-year period from March 1988 to March 1990, Japanese investment flows to EC were 13 per cent higher than the total flows over the previous 36 years combined; in the United States, Japanese flows during the period 1988-1989 exceeded by 8 per cent the total amount invested over the previous 36 years combined. 14/

32. These trends reflect, in part, a strategy being adopted by many Japanese companies to become regional "insiders" in the triad. In both EC and the United States, as well as in Asia, there is evidence that Japanese transnational corporations hope to build up regionally integrated, independently sustainable networks of overseas investments which would serve multiple strategic objectives: to ensure access to each of the three regions, which represent two of the world's largest markets (Europe and the United States) and its most dynamic region (Asia); to insulate Japanese transnational corporations from the threat (real or perceived) of protectionism against Japanese exports in the United States and Europe; and to leverage locational advantages in each of the three regions to increase trade with other markets - including Japan - so as to reduce Japan's trade surplus with its major trading partners (figure II).

33. Within the triad, the bulk of Japanese manufacturing investments are trade-replacing in nature, concentrated in industries such as automobiles and electronics. Japanese strategies in the United States and Europe are predominantly geared to serving local markets, with less than 5 per cent of sales exported to other countries, although this proportion may rise as Japanese affiliates mature. 15/ Recent evidence shows that Japanese transnational corporations are beginning to build networks of suppliers to serve their overseas affiliates and that they are increasingly replicating overseas the close, interfirm relationships within those networks that have been key to their successful growth in Japan. The overseas suppliers of Japanese affiliates in the United States and Europe are often themselves affiliates of Japanese companies. Trends thus indicate a rise in local content by Japanese affiliates located in the triad (though often achieved through sourcing from locally based Japanese suppliers), as well as rising independence from the parent in an effort to achieve "insider" status.

34. In 1989, EC surpassed the United States for the first time in terms of the growth of inward flows from Japan. This is a result of the rising strategic importance of EC for Japanese firms: a recent poll found that, between 1987 and 1989, the percentage of Japanese companies citing North America as the most important region for investment fell from 53 per cent to 43 per cent; those citing Asia remained stable at 42 per cent; and those citing EC as the most important investment location rose from 3 per cent to 12 per cent. 16/ This shift indicates a gradual weakening of the United States as the dominant triad member, as improved economic conditions and new opportunities in EC increase its relative position within the triad.

Figure II. Overseas network of affiliates of the NEC Corporation, 1989



Source: NEC (Nippon Electric Company).

3. Conclusion: movement towards convergence within the triad?

35. In the early 1980s, it would have been difficult to characterize the United States, EC and Japan as forming a triad which dominated global foreign-direct-investment stocks and flows. The role of Japan was then relatively insignificant and EC was too fragmented, more a collection of 12 countries than an integrated regional economy. At that time, the United States was the single most important home and host country for foreign direct investment in the world economy. By the end of the 1980s, as the above data show, a triad had indeed emerged, at least in terms of flow data. Behind the emergence of a tripolar structure are the rapid growth of outward investment from Japan and the integration of EC, such that it now may properly be considered a single triad member. While by 1990 it appeared that the United States and EC were jointly the most important triad members, if current trends continue, EC could eventually surpass the United States as the most important host region in terms of stock (it is already the larger home region) and Japan could, within the next few years, surpass the United States as a home country, also in terms of stock (these changes could be mitigated if the growth of investment into EC slackens once the initial impact of the 1992 programme has occurred and if Japanese investment abroad slows down in the 1990s).

36. From a strategy point of view, the convergence of intra-triad foreign-direct-investment relationships points to the growing importance given to the triad by transnational corporations. This strategy, often referred to as "globalization", means that transnational corporations are increasingly regarding their non-domestic triad activities and their home-country operations as equally important. The recent Japanese strategy to become "regional insiders" in each leg of the triad is motivated both by efficiency reasons (country specialization and regional economies of scale) and by policy considerations (extraregional tariff and non-tariff barriers). If the Japanese foreign-direct-investment strategy proves successful, then the question arises whether EC and United States transnational corporations, in order to ensure competitive survival, will also have to adopt a three-legged strategy in each member of the triad. The incentive to do so will be greater if regional trade blocs are strengthened in Europe, North America and Asia so that achieving "insider" status would be an important competitive advantage to gaining access to those markets.

37. Against such a scenario, the low levels of investment into Japan stand out as a striking imbalance; such a situation might eventually lead to increased policy pressures on Japan to open its economy to more inward foreign investment from the other two triad members. It would also be likely that EC and, in particular, the United States, would respond to this potential competitive threat to their transnational corporations by utilizing strategic trade and foreign-direct-investment policy tools, in an attempt to attain a "level playing field" in bilateral foreign-direct-investment relationships with Japan.

C. The triad, developing and Eastern European countries

1. Foreign-direct-investment clusters of triad members

38. The triad was the main source of foreign direct investment to the rest of the world in the 1980s. Table 4 shows stock and flow data reported by some 30 host developing and Eastern European countries, which collectively account for about 16 per cent of world foreign-direct-investment inflows (77 per cent of inflows to all developing countries). Stock data, shown in section A of the table, reflect the historical activity of transnational corporations which has led to the current distribution of foreign direct investment; flow data, shown in section B, point to emerging trends which are likely to reshape the distribution of foreign-direct-investment stock in the future. The table is organized to show the relative position of each of the triad members from a host-country perspective by measuring the extent to which any single triad member dominates the inward investment of a host country. It reveals that for most host countries, a single triad member accounts for over half of total inward investment stocks and flows. Thus, the three triad members not only dominate foreign direct investment within the triad, but do so individually in most other countries as well. The foreign-direct-investment activities of the triad members are thus likely to have repercussions for the rest of the world, most of which is closely linked to one or more triad members as a host country.

39. Within this overall pattern, the association of host countries with home countries in the triad shifted in the 1980s - but, surprisingly, not by very much. These changes, which are best captured in flows rather than stocks of foreign direct investment, suggest a pattern whereby host countries located in the same geographical region are clustered around a single triad member in the same region. Thus, while the number of countries for which individual members of the triad dominate foreign direct investment has remained about the same over the 1980s, by the late 1980s the distribution of several of those countries had shifted (see figure III, which summarizes the data in table 4, sect. B).

40. From the viewpoint of corporate strategy, a parallel pattern is emerging, which is likely to further the trends noted above. Many transnational corporations in the triad appear to be adopting a similar strategic orientation, which might be termed a regional core network strategy. Such a strategy involves building up integrated networks of affiliates in each of the triad regions: North America, Asia and Europe, with operations in the triad member itself at the core of the integrated network. In some cases (particularly those of Japanese affiliates in Asia and United States affiliates in Mexico), there appears to be a rise in the level of value-added performed by overseas affiliates and in the latter's overall strategic importance to the parent company. Thus, the emerging pattern in the data, which shows countries in a region clustered around a single triad member, partly reflects the strategies of transnational corporations in the triad to build up regionally integrated networks of affiliates, clustered around their home country (figures II and III).

Table 4. Pattern of foreign direct investment from the triad to developing and Eastern European countries, 1980 and 1987

(Percentage share of foreign direct investment by a triad member in the total inward foreign direct investment of the country)

A. Stock data

Group I. Absolute or relative dominance by a triad member a/

United States				Japan				European Community			
1980		1987		1980		1987		1980		1987	
Mexico	69.0	Mexico	65.5	Rep. of Korea	60.5	Rep. of Korea	53.0	Nigeria	39.3	Nigeria	55.1
Uruguay	68.3			Indonesia	37.5	Indonesia	33.2			Kenya d/	78.8
Bolivia	67.0	Bolivia	71.5							S. Africa	66.3
Venezuela	58.6	Venezuela	55.3								
Peru	55.9	Peru	49.1					Paraguay	32.3	Paraguay	46.2
Ecuador	54.3	Ecuador	54.1							Brazil	37.9
Colombia	54.1	Colombia	73.5							Uruguay	33.9
Chile	48.8	Chile	52.1								
								Bangladesh	81.4	Bangladesh	55.9
Philippines	54.6	Philippines	57.3					India	62.3	India	48.0
Hong Kong	40.2	Hong Kong	38.8					Singapore	32.3		
Taiwan, Province of China	35.0							Malaysia	26.6		
										Viet Nam d/	57.2

Group II. Competing shares of two triad members b/

United States/Japan				United States/European Community				European Community/Japan			
1980		1987		1980		1987		1980		1987	
Thailand	(32.8/29.0)	Thailand	(29.5/30.6)	Argentina	(38.8/41.4)	Argentina	(42.4/37.6)			Malaysia	(24.0/20.1)
		Taiwan, Province of China	(34.4/25.5)	Brazil	(28.6/33.6)						
						Singapore	(19.5/23.3)				
						Pakistan	(23.5/26.8)				

Group III. Non-triad countries are the largest investors c/

East, South and South-East Asia				Australia				Other			
1980		1987		1980		1987		1980		1987	
China	38.8	China	63.9	Papua New Guinea	74.0	Papua New Guinea	55.1	Pakistan	32.3		
Sri Lanka	18.8	Sri Lanka	36.0								

/...

Table 4 (continued)

B. Flow data

Group I. Absolute or relative dominance by a triad member a/

United States				Japan				European Community			
1980-1984		1985-1988		1980-1984		1985-1988		1980-1984		1985-1988	
Bolivia	79.3	Bolivia	82.1			Rep. of Korea	51.8	Pakistan	40.2	Viet Nam	57.2
Mexico	62.7	Mexico	60.5			Thailand	46.1	Bangladesh	35.9	Indonesia	28.9
Colombia	60.1	Colombia	98.1			Hong Kong	31.9				
Venezuela	59.6	Venezuela	44.7					Chile	45.1	Brazil	48.8
Argentina	50.3	Argentina	49.7			Fiji d/	47.2			Peru	23.0
Brazil	48.3										
Panama	42.8	Panama	54.3					Nigeria	60.2	Ghana d/	39.5
Peru	29.0										
		Chile	45.1							Yugoslavia d/	64.1
Hong Kong	55.8									Poland d/	63.2
Philippines	55.7	Philippines	61.5							Czechoslovakia d/	44.8
Singapore	51.6									Hungary d/	42.4
Rep. of Korea	46.6									USSR d/	38.3
Papua New Guinea	44.2	Papua New Guinea	42.7								
Taiwan, Province of China	37.1										
		Pakistan	51.3								
		Saudi Arabia d/	34.3								

Group II. Competing shares of two triad members b/

United States/Japan				Japan/European Community				United States/European Community			
1980-1984		1985-1988		1980-1984		1985-1988		1980-1984		1985-1988	
Thailand	(27.6/25.8)	Taiwan, Province of China	(27.87/30.9)	Indonesia	(22.1/24.4)					India	(33.7/33.3)
		Singapore	(38.60/39.2)							Nigeria	(36.5/33.3)

Group III. Non-triad countries are the largest investors c/

South-East Asia				Other Western Europe				Other			
1980-1984		1985-1988		1980-1984		1985-1988		1980-1984		1985-1988	
China	67.0	China	61.0	Morocco	35.2	Morocco	40.0	Ecuador	34.8	Ecuador	36.0
Sri Lanka	37.5	Sri Lanka	32.4							Uruguay	56.8
Malaysia	22.2	Malaysia	30.8								
		Nepal d/	57.4								
		Mauritius	37.3								

(Source and footnotes on following page)

(Source and footnotes to table 4)

Source: Handbook on Foreign Direct Investment (to be issued as a United Nations publication).

a/ Group I: A triad member has absolute dominance in a host country if it accounts for more than 50 per cent of total inward foreign direct investment in that host country. A triad member has relative dominance in a host country if it is the largest foreign direct investor by a margin of at least 10 per cent more than the next largest investor.

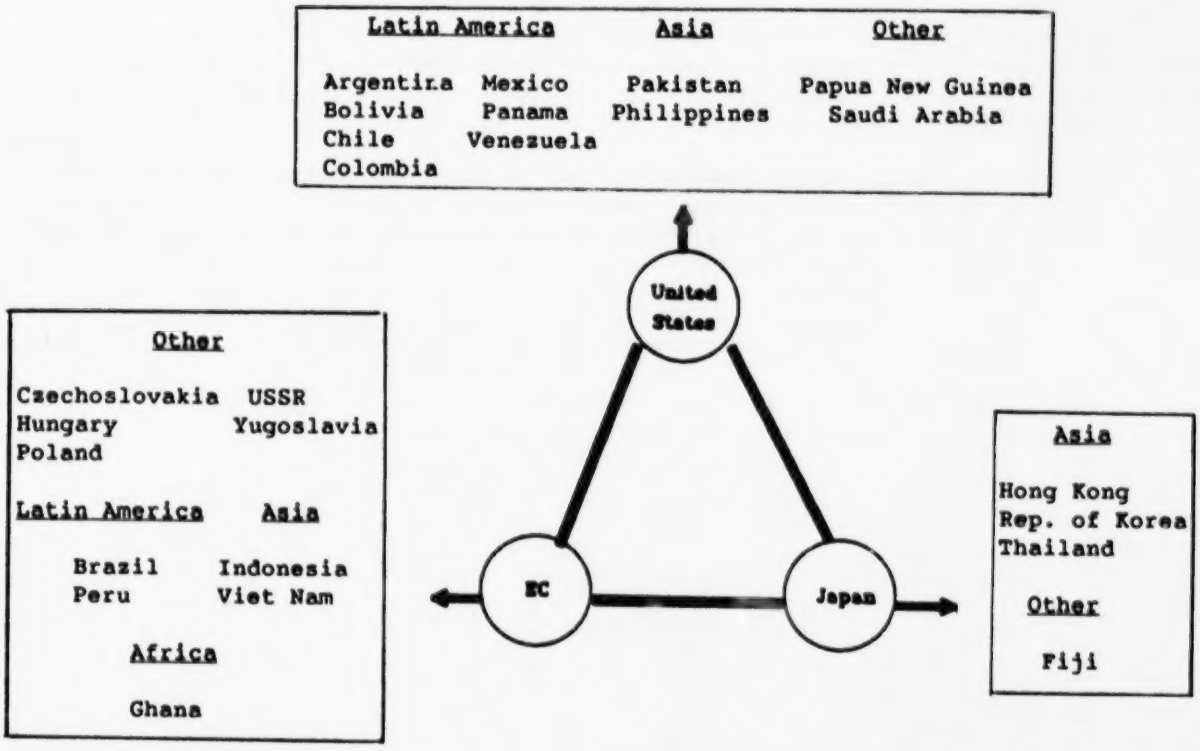
b/ Group II shows host countries for which two triad members hold comparable shares of total inward foreign direct investment and for which the triad as a whole constitutes the dominant foreign direct investor (greater than 50 per cent share of total inward foreign direct investment).

c/ Group III shows countries for which foreign direct investment by non-triad countries exceeds that of the triad. The home country and its share are indicated.

d/ Data are available for 1987 only.

Figure III. Foreign-direct-investment clusters of triad members, 1985-1989

(Countries for which a triad member accounts for over 50 per cent of average annual foreign-direct-investment inflows)



Source: Based on table 4.

(a) The United States cluster

41. Both flow and stock data for the 1980s indicate a decline in the number of host countries for which the United States is the dominant investor. Still, it remains the largest investor in many countries, most of them located in Central and South America. Indeed, the share of United States inward investment flows to those countries over the 1980s either increased or remained stable (with the exception of Brazil and Peru, where by the late 1980s EC held the largest share of inward flows, and Venezuela, where the United States remained dominant but where its share fell). However, there has been a clear decline in the relative position of the United States as the largest investor in five Asian host countries of areas (Hong Kong, the Republic of Korea, Taiwan Province of China, Thailand and Singapore). In the case of Taiwan Province of China, the United States went from a position of relative dominance to one of shared dominance in terms of inward stock; for the others, there was a fall in the United States share of inward flows. In nearly all cases, the loss in share was in favour of Japan, which by the late 1980s had either increased its share to hold a share comparable to that of the United States, or had replaced the United States altogether as the single dominant home country.

42. Within Latin America, Mexico is emerging as a key host country for many United States transnational corporations. While the position of the United States in Mexico remained stable over the 1980s, Mexico accounted for two thirds of the total 1987-1988 growth in employment by the developing country affiliates of United States transnational corporations. 17/ In the 1970s and early 1980s, United States transnational corporations were attracted by Mexico's geographical position, its low wage rates and the free-export zones (maquiladoras) on the United States-Mexican border. Now, several transnational corporations are responding to an improved economic climate and an increasingly skilled workforce by increasing the strategic importance of their Mexican subsidiaries in order to engage in production for both the Mexican and the United States market. Ford has recently invested $1 billion in its Mexican export subsidiary, a state-of-the-art manufacturing plant; IBM and Hewlett-Packard manufacture computers for both the local market and for export; and General Electric has integrated its Mexican joint venture with its Canadian and United States operations.

43. A free trade agreement, now being considered and favoured in principle by the United States and Mexico, is likely to stimulate increased United States foreign direct investment in Mexico, aimed at both local and export markets, while lessening the importance of maquiladoras. If such an agreement were to stipulate strict local-content requirements in order for goods to be freely traded in the region, then the Mexican subsidiaries of third countries (particularly from Japan and Europe, which have also invested substantially in Mexico) could be at a disadvantage vis-à-vis American transnational corporations, thus furthering the trend of a North American regional network. Such a trend could eventually spread to include other Latin American countries, as indicated by current discussions of a hemispheric free trade zone which would comprise North, Central and South America, thereby creating the largest free-trade area in the world.

(b) The Japanese cluster

44. As indicated above, the data in table 4 show a gradual clustering of Asian host countries around Japan as a home country, although by the late 1980s Japan was the dominant investor in only two Asian countries in terms of stock and in only three in terms of flows (however, by the late 1980s no other triad member dominated flows to any Asian country, with the exception of EC in Indonesia and Viet Nam). Thus, Japan has not yet emerged as an equal member of the triad from the point of view of its non-triad foreign-direct-investment position, but current trends point to its growing importance, particularly in Asia.

45. The growing importance of Japan is illustrated by the fact that Japanese transnational corporations have nearly as many affiliates in Asia as they do in EC and the United States combined, although their strategy in Asia differs from that in the triad. Rather than being geared to the local market, as they are in the triad, the Asian affiliates of Japanese transnational corporations export nearly 50 per cent of their sales, with one third exported to third countries and the rest back to Japan. The dominant strategy until now has thus been to utilize the region as a low-cost export base; the high export ratio of Asian affiliates also points to the more mature phase of Japanese investments in that region (which began in the late 1960s in labour-intensive industries in which Japan had lost its competitive advantage). 18/

46. Trends in the strategies of Japanese transnational corporations indicate that, in the late 1980s and early 1990s, a new phase in Japanese investment in the region may be beginning, which is fuelling the rapid ascent of Japan as a home country. Since the appreciation of the yen in 1985, Japanese foreign direct investment into East and South-East Asia has grown so rapidly (faster than it did in Europe or the United States) that press reports have recently referred to the region as a "Japan-led economic bloc". 19/

47. While Japanese transnational corporations are still attracted to the developing Asian countries by low-cost labour, rapid demand growth in the region has increasingly been an important motive. In recent years, growth in the Asian newly industrialized countries has outpaced that in the countries members of the Organisation for Economic Cooperation and Development (OECD), a trend which is expected to continue in the 1990s. Rationalized, export-oriented strategies that take advantage of low labour costs are yielding to rationalized market-oriented investments aimed at capturing regional market shares. In those economies in which labour costs have risen, such as Hong Kong, the Republic of Korea, Singapore and Taiwan Province of China, total foreign direct investment has not declined, but rather manufacturing investments are giving way to investments in finance and services where low labour costs are less of a consideration.

48. The indication that transnational corporations from the triad are building up regional core networks around their home countries is best illustrated by the case of Japanese investment in the Asian region. In manufacturing, many Japanese transnational corporations are integrating their Asian affiliates on a regional scale, investing in complementary operations in different countries. Increasingly, these vertically integrated Asian production networks do not depend on Japanese

inputs. Singapore often serves as the regional headquarters and information and distribution centre (as well as the site for the most sophisticated manufacturing operations), with plants in less developed countries such as Malaysia, the Philippines and Thailand performing a range of discrete manufacturing operations. Such networks are often geared towards supplying the regional market as well as exporting to the three legs of the triad. In 1989, Toyota integrated its Asian subsidiaries (in four countries members of the Association of South-East Asian Nations (ASEAN) with regional headquarters in Singapore) so that they can supply one another, rather than import components from the Japanese parent, which instead will import from the ASEAN affiliates; the strategy was prompted, in part, by a 1988 reduction in tariffs on intra-firm trade in the region. 20/ Japanese motor vehicles manufacturers direct their subsidiaries in each country to specialize in certain components and have negotiated with Governments to allow such output to be treated as if it were "domestic content". 21/ Such a strategy permits plant specialization, regional economies of scale and intra-firm trade for transnational corporations, and furthers regional economic integration among the ASEAN countries.

49. The Asian affiliates of Japanese transnational corporations are also significant exporters. Their export activities tend to be part of a global integration strategy by the parent firm: of the total exports of Asian affiliates to Japan, the United States and Europe, 76 per cent, 58 per cent and 51 per cent of those exports, respectively, went to other affiliates of the same Japanese parent. 22/ If current trends continue, it is likely that not only will Japanese transnational corporations come to dominate investment flows to East and South-East Asian countries, but that they will also account for a rising proportion of trade among those countries and between the region and the rest of the world.

(c) The European Community cluster

50. The data in table 4 show an increase in the number of host countries in which EC is the largest investor, at least in terms of flows, attesting to the rise of the EC position within the triad. In terms of stock, EC has maintained its share in those Asian and African countries where historical ties remain strong, although no particular regional pattern emerges from an analysis of those countries. However, in all of the countries in Eastern Europe for which data are available, EC is the dominant inward investor. At the end of 1989, EC members accounted for 1,570 or 48 per cent of a total number of 3,280 joint ventures in Hungary, Poland, Czechoslovakia and the USSR. 23/ In most of these countries, new equity investments build on long-standing non-equity relationships, particularly subcontracting arrangements. Thus, the opening of Eastern Europe to foreign investment appears to be leading to a similar clustering pattern as can be observed in Asia and Latin America. As with Japanese investments in Asia and United States investments in Mexico, EC investments in Eastern Europe are aimed at both capturing local demand and creating a production base from which to export to other countries. Unlike the first two instances, however, many investments in Eastern Europe must rely more on future potential than on present returns.

51. Using their pre-existing distribution and marketing channels, EC firms are in many cases striving to integrate their Eastern European operations into their current networks, with the 1992 single market programme of EC an added incentive to

extend production to the East. Fiat's strategy in the region, for instance, envisions an integrated trans-European network which will not only produce for Eastern European markets, but will strengthen Fiat's competitive position in EC through plant specialization and intra-firm trade. Although in the current climate the risk factor of Eastern European investments is high, many transnational corporations hope to gain "first-mover" advantages by setting up joint ventures with local firms. The growth of such investments may be limited by the number of existing firms able to cooperate with them, and could reach a plateau in a few years. Still, if current trends continue, the role of EC transnational corporations in Eastern Europe may come to resemble the relationships of Japanese transnational corporations with their Asian subsidiaries and United States transnational corporations with their Mexican subsidiaries: increasing value performed at the affiliate level and growing trade among parents and affiliates, trends which both respond to and reinforce parallel developments at the policy level to further integrate the economies of home and host countries.

(d) The newly-industrialized-countries cluster

52. Table 4 shows that the Asian newly industrialized countries have emerged in the 1980s as increasingly important foreign investors, particularly in the region itself, where newly industrialized countries are now the largest foreign investors in four less developed Asian countries (in terms of flows). Behind this rise are rising wage rates at home, appreciating currencies coupled with large balance-of-payments surpluses due to high export earnings, capital market liberalizations in Taiwan Province of China and the Republic of Korea and the loss of generalized system of preferences (GSP) status. Taiwan Province of China in particular has emerged as a major investor in the region, establishing production facilities in several countries in South-East Asia and in China, either directly or through affiliates in Hong Kong. In 1989, foreign direct investment outflows from Taiwan Province of China were four times the level of inflows. Foreign direct investment from Hong Kong has also grown rapidly since 1986 and, by one estimate, accounts for 10 per cent of all foreign direct investment in East Asia (excluding China). 24/ The newly industrialized countries are therefore emerging as important sources of foreign direct investment in Asia, which, along with Japanese investments in the region, will serve to further economic integration among the individual countries.

2. Explaining regional investment clusters

53. The data presented above indicate a continuing pattern of clustering of host countries in a region around a single home triad member located in the same region. According to theory, such a pattern is unlikely to occur; the distribution of foreign direct investment should reflect the location advantages of host countries, rather than their geographical proximity to a home country. While geographical factors are certainly important, other location advantages include the host country's natural endowments, its infrastructure and human resources, as well as those aspects of its policy environment which have an impact on foreign direct investment. Such factors are considered a primary determinant of why transnational corporations, having decided to invest abroad, will invest in one host country

rather than another. A geographically based pattern of foreign direct investment would not be expected to occur since the type of foreign direct investment that transnational corporations wish to undertake, not the transnational corporations' country of origin, should determine the relevant location advantages of a host country. For resource-based foreign direct investment, for example, the availability of natural resources in the host country will be an important locational determinant for transnational corporations, irrespective of their country of origin. For export-oriented foreign direct investment, production costs and exchange-rate policy would be important factors. For foreign direct investment to serve the local market, the size and growth of domestic demand would be relevant (as discussed above, the locational advantage of market size is an important variable behind the high levels of foreign direct investment in the triad, since much of such investment is geared towards serving triad markets). Assuming a similar set of possible locations available to foreign investors, it would thus be expected that the distribution of global foreign-direct-investment stocks and flows would not disproportionately reflect investment from any individual triad member. Transnational corporations would invest in those host countries which best met their investment requirements, regardless of their country of origin. Therefore, no single triad member would be expected to emerge as the dominant investor in a particular host country.

54. However, other factors may play a role in the distribution of worldwide investment flows, which might lead to the concentration of foreign direct investment by a single triad member in a given host country. These include cultural, historical, commercial and political links between home and host country. Also relevent is the competitiveness of firms from the home country, especially in regard to their experience in investing abroad and, in particular, to their access to market information for a wide range of possible host countries (as opposed to a limited set of nearby locations). Specifically, at the early stage of the home country's outward investment development path, firms tend to be small or medium-sized enterprises which lack the necessary resources and information to behave as global investors. Such firms may limit their initial overseas investments to nearby countries and to those with historical, political and commercial ties with their home country, even if superior locational advantages exist elsewhere.

55. The formation of a regional free-trade area with one of the triad members at its core could, hypothetically, also lead to a pattern in which foreign direct investment from the triad member would predominate in other countries within its free-trade area. This might occur if the opening up of the regional market to free trade led to increased intra-regional foreign direct investment, while at the same time transnational corporations from outside the region faced constraints to investing in the region.

56. Finally, since foreign direct investment is interlinked with trade, technology and financial flows (see sect. III), the patterns of these flows are also likely to influence the pattern of investment. In addition, the patterns of development assistance are likely to have an influence, especially as far as developing countries are concerned and, in the future, perhaps Central and Eastern European countries as well. In relation to the other members of the triad, the United States declined in importance as an aid donor in the 1980s; but the countries where

the United States is the primary donor are in Latin America. Japan has grown in importance as a donor, especially in Asia. The European Community is an important donor to developing countries in all major regions. Though the determinants of development assistance are not identical with those of foreign investment, the granting of aid has, in some instances, been linked to trade and foreign-direct-investment relationships. 25/

57. If these factors play an important role in the locational decisions of foreign investors, then an asymmetrical pattern might emerge in which foreign direct investment in a given host country or region is centred on a single home country. Such a pattern is indeed evident in the data presented in table 4 and the question arises as to which of the factors described above can explain the emergence of regional investment clusters. Colonial and, in some cases, political relationships appear to explain some of the linkages. But in others the key explanatory variables appear to be the globalization strategies of transnational corporations coupled with a trend towards the formation of regional trading blocs around each triad member. Thus, the interaction of several variables - the emergence of EC and Japan as key triad members, the opening up of Eastern Europe to foreign direct investment, the efforts made by transnational corporations to attain a global market share, and regional integration efforts at the policy level - appears to be leading to a pattern in which geographical and policy linkages to the home country, in addition to the locational advantages of host countries, are emerging as the key determinants of the global distribution of foreign direct investment.

III. INTERLINKAGES AND POLICY IMPLICATIONS

A. Interlinkages

58. The global pattern of foreign-direct-investment stocks and flows, along with the global patterns of trade, technology transfer and financial flows, is one of the most significant structural characteristics of the international economy. All four dimensions are interlinked to a significant extent through the activities of the transnational corporation:

> Much of world trade - world exports reached $3.8 trillion in 1989 - is undertaken by transnational corporations or propelled by foreign direct investment. Transnational corporations are responsible for a substantial share of world exports and imports; in the case of the United States, for example, at least 80 per cent of the country's trade was undertaken by transnational corporations in 1988. If only trade related to foreign direct investment is considered, the role of transnational corporations is still quite important. To use again the example of the United States: in 1988, the foreign affiliates of United States-based transnational corporations exported $87 billion in goods and services to the United States, accounting for about 19 per cent of all United States imports. The United States-based affiliates of foreign transnational corporations accounted for an additional 34 per cent of imports, implying that 53 per cent of United States imports passed through the affiliates of transnational corporations. 26/ In the case of Japan, foreign-direct-investment-related imports of manufactured goods from Asia have been growing, though overall the volumes involved are still relatively low.

However, in some industries (such as general machinery, electrical machinery, transportation and precision equipment), about three quarters of Japanese imports from Asia in 1986 were shipped by Japanese affiliates. 27/ Transnational corporations are also involved in trade between their host country production locations and third-country markets. In 1988, third-country exports by foreign affiliates of United States-based transnational corporations were almost 70 per cent as large as all exports from the United States; the intra-firm portion of these third-country exports rose, from 44 per cent in 1985 to more than 50 per cent in 1987 and 1988. 28/ Furthermore, transnational corporations have helped stimulate exports from developing countries, either through their affiliates or through links with national companies. In the case of newly industrializing countries in Latin America and Asia, transnational corporations from Japan, Sweden and the United States helped stimulate exports in manufacturing industries. 29/ Several Asian developing countries have become major exporters, in part by drawing upon the technology, organizational skills and marketing networks of transnational corporations from developed market economies to produce components, and have become original equipment manufacturers and exporters of their own branded products in developed country markets.

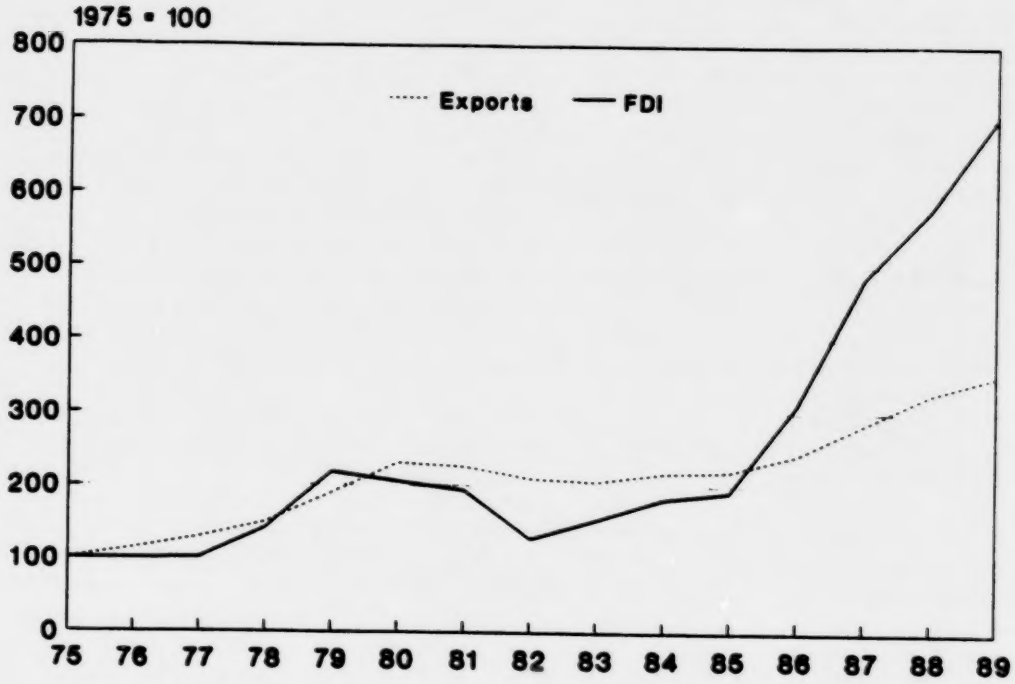
Transnational corporations also play a major role in the international transfer of technology. In so far as such transfers take place through trade in capital goods, transnational corporations contribute to the process through their participation in trade. Moreover, as of the mid-1980s, some 80 per cent to 90 per cent of technology payments by developing countries to Germany and the United States took the form of payments from affiliates to their parent companies, that is, they were directly associated with foreign direct investment. 30/

As regards the area of finance, transnational banks are the principal sources of private international financial flows. But foreign-direct-investment flows in and by themselves also represent a significant share of international financial flows. In the case of the developing countries, for example, such flows accounted for 75 per cent of total long-term flows from private sources (excluding private non-guaranteed credit) to those countries during the period 1987-1989. 31/

Transnational corporations are therefore central institutions in the international economy for developed and developing countries alike.

59. The dynamism of foreign direct investment can best be illustrated by comparisons with world exports and world output. After having recovered from the slow growth years of the early 1980s, foreign-direct-investment flows grew by over 350 per cent between 1983 and 1989 (for an average annual rate of growth of 29 per cent), in contrast to world exports which grew (from a much larger base) by about 73 per cent over the same period (for an average annual rate of growth of 9 per cent) (see figure IV and table 5). Furthermore, foreign direct investment has grown more than three times as fast as world output during the period 1983-1989 (see table 5). This suggests that foreign direct investment is associated with an increasing share of world output. This raises the possibility that foreign direct investment is increasingly assuming the role of a principal engine of growth.

Figure IV. Index of current value of exports and foreign-direct-investment outflows, 1975-1989



Sources: Estimates made by the United Nations Centre on Transnational Corporations, based on Handbook on Foreign Direct Investment (to be issued as a United Nations publication), International Monetary Fund balance-of-payments tape, retrieved on 10 January 1991, and United Nations, Monthly Bulletin of Statistics, October 1984 and October 1990.

Table 5. Growth in current value of world foreign-direct-investment outflows, exports and gross domestic product, 1983-1989

(Average annual percentage change)

	1983-1989
World foreign-direct-investment outflows	28.9
World exports	9.4
World gross domestic product	7.8

Sources: Estimates made by the United Nations Centre on Transnational Corporations, based on Handbook on Foreign Direct Investment (to be issued as a United Nations publication), International Monetary Fund, Direction of Trade Statistics, 1990 (Washington, D.C., 1990), National Accounts Statistics: Analysis of Main Aggregates, 1987 (United Nations publication, Sales. No. E.90.XVII.8) and World Economic Survey, 1990 (United Nations publication, Sales No. E.90.II.C.1).

B. The need for a multilateral framework for governance

60. One implication of the foregoing analysis is that the central and growing importance of foreign direct investment raises anew and reinforces the urgency of a multilateral framework for foreign direct investment and the broader issue of governance in a world economy in which investment, trade, technology and financial flows are closely intertwined. Over the past decade, a growing number of international norms has produced a body of international soft law on transnational corporations; it is, however, limited in scope and does not adequately match the globalization of business activity. In an era of globalization, it is increasingly difficult to distinguish between national and international issues of governance. The capacity of Governments to manage their economies and achieve national objectives in areas ranging from fiscal policy to environmental control is being strained by the growing importance of transnational corporations in the international economy. Many issues related to corporate responsibility cannot be resolved satisfactorily in the context of a single national legal regime. Even among developed countries, the need for policy coordination is being felt, for example, in the area of transfer pricing. Competition among countries for more foreign direct investment, if free from any rules, may lead to a "beggar-thy-neighbour" policy and detract from the bargaining power of Governments vis-à-vis transnational corporations. Therefore, the effective and stable governance of international economic relations requires not only the unleashing of market forces and private enterprise, but also effective international instruments to deal with the broad range of issues related to the globalization of business activity - problems that are beyond the capacity of national regimes of governance.

61. The crucial importance of a multilateral framework is reinforced by the distribution of worldwide foreign direct investment. Since the rate of growth of foreign direct investment within the triad has outpaced that of the rest of the world, intra-triad foreign direct investment stock has increased from one third in 1980 to two fifths in 1989. Moreover, the triad members dominate foreign direct investment not only within triad, but in most other countries as well. This pattern has been brought about by the strategies of transnational corporations under which they appear to be assigning great importance to their presence in each member of the triad and to building regionally integrated core networks of affiliates clustered around their home countries. If this pattern persists, the possibility arises that foreign-direct-investment regimes will be increasingly determined by either bilateral negotiations among triad members and/or regional negotiations with one of the triad members. In the absence of a multilateral framework formulated with the participation of all members of the international community, a large number of countries run the risk of not having an effective voice in the determination of the foreign-direct-investment regime governing international economic relations.

C. Policy implications for improving foreign-direct-investment flows to developing countries

62. Within a broader multilateral context, special attention needs to be given to developing countries. Despite an increase in the absolute volume of foreign-direct-investment inflows to developing countries, the decline of their share in worldwide flows has continued in the late 1980s. Considering the pivotal role that foreign direct investment plays in economic development - not only in its own right, but also because of its close interlinkages with trade, technology and financial flows - there is a need to reverse the marginalization of developing countries and the resultant inequity in the international division of labour. This, in turn, raises the question to what extent can co-ordinated public policies by host countries, home countries and international institutions play a role.

63. In this context, it may be recalled that, at the same time as an increasing share of worldwide inward foreign direct investment is being concentrated in the triad, the sources of such investment are diversifying somewhat. As a result, developing countries must compete for a smaller share of inward investment from a growing array of sources. Within the triad, EC has increased its role as a home country and Japan has emerged as a significant source of outward investment, while the United States, compared with the other triad members, has declined markedly as a home country. If geographical location and regional economic integration are indeed significant determinants of the location of foreign direct investment, then those developing countries which lack such attributes risk becoming marginalized in the world economy. Furthermore, if the corporate strategy to become "regional insiders" in each leg of the triad becomes widespread, then many developing countries - as "outsiders" - may become even more peripheral, serving primarily as locations to sustain the competitive position of transnational corporations in the triad.

64. The task of policy-making in foreign direct investment in a world characterized by a triad will become increasingly complex for developing countries. In particular, the margin for effective policy-making utilizing traditional liberalization and incentive instruments is narrowing, 32/ though the scope for further improvement in the foreign-direct-investment framework by all developing countries has not been exhausted. This is because the scope for further liberalization and additional incentives diminishes as more and more of such measures are implemented; in addition, the effectiveness of such measures in attracting investment becomes more limited when virtually all countries have adopted them. In this light, it may be appropriate for developing countries to review their investment incentives and to structure them on the basis of a co-ordinated and realistic appraisal of their effectiveness.

65. At the same time, developing countries must recognize the new opportunities that are presenting themselves. They stem from the emergence of a triad in outward investment, as opposed to the domination of the United States as a home country 10 years ago; the growing number of home countries outside the triad, particularly among the newly industrialized countries; and the globalization strategies of transnational corporations from the triad, implying a continual search for new markets and production locations. But the creation of an attractive foreign-direct-investment regime alone, although necessary, is not sufficient to enable a country to take advantage of these opportunities. Additionally, measures are needed to improve domestic economic performance in general, and in particular to increase demand growth, and to improve infrastructure and human resources. Thus, measures to attract foreign investment will increasingly have to encompass policies beyond traditional regulatory and promotional instruments. Incentives provided on a multi-country level are also likely to prove more effective - particularly if the pattern of regional investment clusters described above and the strategies of transnational corporations to form regional core networks of affiliates, prove to be important developments in the 1990s.

66. Given the increasing share of global foreign direct investment directed towards the triad and the additional competition for foreign direct investment from Central and Eastern Europe, policy makers in developing countries should make efforts to diversify sources of inward investment. Such sources might include non-triad developed countries, emerging home countries among the newly industrialized countries, as well as small and medium-sized companies from both developed and developing countries.

67. While increasing investment flows is important, policy-making should not be singularly focused on the quantitative aspect. Developing host countries would be well advised to undertake systematic assessments of the foreign direct investment they receive, where it can make a significant qualitative contribution and explore ways and means to enhance this contribution.

68. The emergence of regional networks of affiliates with a triad member at the core of the networks appears to be accompanied by a gradual rise in the level of value-added being generated by developing-country affiliates in the networks. Intra-firm trade within these networks has been instrumental in promoting exports from host countries, particularly those which are incorporated into the networks of

Japanese transnational corporations. These networks can also strengthen regional integration among developing and developed countries and often serve to lay the groundwork for successful initiatives in the policy sphere. In so far as foreign direct investment is driven by regional core network strategies of transnational corporations, regional integration schemes which do not include a triad member do not seem to have succeeded in accelerating foreign-direct-investment inflows. 33/ Hence triad members as well as other developed countries should assist developing countries in structuring regional integration arrangements in a manner that can boost investment inflows, including inflows from non-triad home countries.

69. Home countries could also assist by strengthening incentives to their transnational corporations for investment in developing countries. These incentives can take the forms of providing guarantees, risk insurance, preferential tax treatment of profits and dividends earned in developing countries, financial support for market investigations and feasibility studies and preferential market access to exports from developing countries. Many developed countries already have some schemes in these areas. 34/ What is required is a fresh examination of the existing measures and the determination to improve and supplement them to increase their effectiveness.

70. There is also a role for multilateral institutions. They can contribute towards increasing the locational advantages of developing countries by providing financial and technical assistance in such areas as improvement of infrastructure, the development of human resources and the design of promotional services. Perhaps more important, they can help developing countries in improving the quality of foreign direct investment and increasing the gains therefrom through technical assistance in a variety of areas. A number of multilateral organizations - particularly organizations of the United Nations system including the World Bank - already have programmes in these areas. Such programmes need to be further supported and augmented.

71. The importance of foreign direct investment as an engine of economic development, not merely in its own right, but also because of its close linkages with trade, technology transfer and financial flows, is by now well established. With that perspective in mind, the international community may wish to consider how to achieve a consensus on ways and means of attracting a greater flow of foreign direct investment to developing countries and to improve its qualitative content. Since the scope for action by individual host countries has become rather limited, the need for co-ordinated multilateral action by all concerned - host countries, home countries and international institutions - is all the more important.

Notes

1/ The concept of a triad in the world economy has become widespread in discussions of international corporate strategy and in descriptions of patterns of economic growth and world trade. See, for instance, Kenichie Ohmae, "The Triad World view", Journal of Business Strategy, No. 7 (spring 1987), pp. 8-19; and Sylvia Ostry, "The implications of developing trends in trade policy", Business Economics, January 1990, pp. 23-27.

Notes (continued)

2/ Trade and Development Report, 1989 (United Nations publication, Sales No. E.89.II.D.14), pp. 71-72; and GATT, International Trade 89-90, vol. I (Geneva, 1990).

3/ Trade and Development Report, 1990 (United Nations publication, Sales No. E.90.II.D.6), pp. 91-95.

4/ Excluded tax havens are Bahamas, Barbados, Bermuda, Cayman Islands, Netherlands Antilles, Panama.

5/ In making these estimates, the United Nations Centre on Transnational Corporations used data from 96 capital-importing developing countries. Net resource transfers are defined as inflows of foreign direct investment (including reinvested earnings) minus remittances on account of such investment (e.g., profits, royalties and technology payments). It should be noted that inflows and outflows are related only over time in that outflows represent earnings realized on earlier inflows.

6/ Beginning-year figure from United Nations Economic Commission for Europe, East-West Joint Ventures News, No. 5 (July 1990), p. 11. End-year figure estimated by the United Nations Centre on Transnational Corporations, based on national sources.

7/ Keith A. Rosten, "Soviet joint ventures riding on troubled waters", The Wall Street Journal, 7 May 1990.

8/ Results of a survey conducted by DRT International, as reported in Business Eastern Europe, 8 October 1990.

9/ In 1980, EC accounted for the dominant share of foreign-direct-investment stock in France; by 1987, EC was dominant in France, Belgium, Italy, Portugal and Spain and was the single largest foreign investor in the Netherlands. In terms of inward flows, EC is the dominant investor in Germany and the Netherlands and holds an equal share with the United States in the United Kingdom.

10/ KPMG, Dealwatch (3rd quarter, 1990).

11/ National Accounts Statistics: Analysis of Main Aggregates, 1987 (United Nations publication, Sales No. E.90.XVII.8).

12/ "Nice view from up here", The Economist, 24 November 1990; and "US exporters that aren't American", Business Week, 29 February 1988.

13/ United States Department of Commerce, Bureau of Economic Analysis, U.S. Direct Investment Abroad: 1982 Benchmark Survey Data (Washington, D.C., 1985).

14/ Ministry of Finance of the Government of Japan.

Notes (continued)

15/ Figures are for 1986. Industrial Bank of Japan, Japanese Finance and Industry, Quarterly Survey, No. 80 (fourth quarter, 1989).

16/ Industrial Bank of Japan, Japanese Finance and Industry, ...

17/ Raymond J. Mataloni, "U.S. multinational companies: operations in 1988", Survey of Current Business, No. 10 (June 1990).

18/ Industrial Bank of Japan, Japanese Finance and Industry, ...

19/ "Japan in East Asia: a boom pays off" International Herald Tribune, 30 May 1990.

20/ Rob Steven, "Japan's MNCs: the new power in Southeast Asia", Multinational Monitor, November 1989.

21/ "Thai economy booming, thanks to the Japanese", The New York Times, 10 May 1990.

22/ Ministry of International Trade and Industry (MITI), Daisankai Kaigai Jigyo Katsudo Kihon Dhosan Kaigai Toshi Tokei Soran (The third basic survey on business activities abroad: statistical compilation on investment abroad) (Tokyo, Keibun Shuppan, May 1989).

23/ By the end of April 1990 for the USSR.

24/ "Hong Kong: Asia its oyster", The Economist, 8 December 1990.

25/ Bernard Wysocki Jr., "Japan plots development of other economies in Asia through aid, investment programs", Asian Wall Street Journal, 27 August 1990; Juichi Inada, "Japan's aid diplomacy: economic, political or strategic?", Millennium, No. 18 (winter 1989), pp. 399-414.

26/ Raymond J. Mataloni, Jr., "U.S. multinational companies: operations in 1988", Survey of Current Business, No. 10 (June 1990), table 5; Ned G. Howenstine, "U.S. affiliates of foreign companies: operations in 1988", Survey of Current Business, No. 10 (July 1990), table 9.

27/ Trade and Development Report, 1990 ..., p. 95.

28/ Mataloni, loc. cit., table 12; Obie G. Wichard, "U.S. multinational companies: operations in 1987", Survey of Current Business, No. 69 (June 1989), table 12.

29/ Transnational Corporations and Manufacturing Exports from Developing Countries (United Nations publication, Sales No. E.90.II.A.21).

30/ Transnational Corporations in World Development: Trends and Prospects (United Nations publication, Sales No. E.88.II.A.7), table XI.1.

Notes (continued)

31/ Estimate made by the United Nations Centre on Transnational Corporations for 96 capital-importing developing countries, based on World Bank World Debt Tables tape and International Monetary Fund balance-of-payments tape.

32/ For an elaboration of this point, see the report of the Secretary-General on the determinants of foreign direct investment and their policy implications (E/C.10/1991/7).

33/ See Regional Economic Integration and Transnational Corporations in the 1990s: Europe 1992, North America, and Developing Countries (United Nations publication, Sales No. E.90.II.A.14), chap. IV.

34/ Foreign Direct Investment, Debt and Home Country Policies (United Nations publication, Sales No. E.90.II.A.16), pp. 26-36.